

A trust which provides for the reversion of principal on termination to the creator does not qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization is, however, allowed deductions by section 642(c) of the Code of those amounts which by the terms of the trust instrument are to be used exclusively for religious, charitable, or educational purposes.

Advice has been requested whether a trust organized and operated in the manner described below may qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The trust agreement provides that its purposes are religious, charitable, and educational. The trust is to continue for a stated number of years, unless extended, or until the death of the survivor of the creator and his wife. After either event the trust shall end and the principal shall be paid to the creator or his estate. The entire net income is to be expended annually for religious, charitable, or educational purposes. In their discretion the trustees may also distribute the trust principal for the stated exempt purposes.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations created and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

The trust agreement provides that all of the net income of the trust must be expended each year for charitable purposes. However, the provision for reversion of trust principal to the creator precludes a trust from being organized and operated exclusively for charitable purposes. Where an individual has a reversionary interest, any gains derived from investing and reinvesting the principal would flow to him. Accordingly, the trust does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

However, section 642(c) of the Code allows deductions to trusts in computing their taxable income for any amount of their gross income (in lieu of the deductions allowed by section 170(a), relating to deduction for charitable contributions and gifts) without limitation, which under the terms of the trust instrument is, during the taxable year, paid or permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes.

Since the net income of the trust is required, under the

terms of the governing trust instrument, to be used exclusively for religious, charitable, or educational purposes, the trust is allowed deductions by section 642(c) of the Code (subject to the limitations of that section) of an amount equal to its entire net income.